MULTIMEDIA UNIVERSITY

STUDENT ID NO

MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 1, 2017/2018

BFE2074 – FINANCIAL ECONOMICS

(All sections / Groups)

21 OCTOBER 2017

9.00 a.m. – 11.00 a.m.

(2 Hours)

INSTRUCTIONS TO STUDENTS

1. This question paper consists of **THREE (3)** pages with **FOUR (4)** questions only.
2. Attempt **ALL** questions. All questions carry equal marks and the distribution of the marks for each question is given.
3. Please write all your answers in the Answer Booklet provided.

Question 1

(a) What does balance-of-payments measure? Name **THREE (3)** main accounts under the balance-of-payments. (5 marks)

(b)

Table 1

Year	CPI Singapore	CPI Malaysia	Spot exchange
2015	159.2	114.4	0.413 S$/RM
2016	186.9	120.4	0.335 S$/RM

*Note: CPI – Consumer Price Index.

Answer the following questions based on the information provided in **Table 1**:

i. What is the amount of percentage change of the appreciation/depreciation of Malaysian ringgit (RM) from year 2015 to 2016? (1 mark)

ii. Calculate the rate of inflation for both Malaysia and Singapore. (2 marks)

iii. Based on the given CPI, calculate the real rate of exchange between Malaysian ringgit (RM) and Singapore dollar (SGD) for both year 2015 and year 2016. (Assuming that the home country is Malaysia) (2 marks)

iv. In real terms, did the Malaysian ringgit (RM) appreciate or depreciate relative to Singapore dollar (SGD)? (1 mark)

(c) The interaction between the demand for a currency and the supply of the currency determines the currency's market.

(i) Illustrate the above currency market using an appropriate graph with complete labels. (use the exchange rate of S= $/RM). (4 marks)

(ii) Explain why the demand for a currency is a derived demand. (2 marks)

(iii) If U.S. consumers demand for Malaysian goods and services, explain the changes on supply of Malaysian ringgit (RM), demand of Malaysian ringgit (RM), exchange rate and the value of Malaysian ringgit (RM) for the above market. Show your answer using a new graph. (4 marks)

(iv) If Malaysian consumers demand for U.S goods and services, explain the changes on supply of Malaysian ringgit (RM), demand of Malaysian ringgit (RM), exchange rate and the value of Malaysian ringgit (RM) for the above market. Show your answer using a new graph. (4 marks)

[Total marks: 20 marks]

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Question 2

(a) Define the term forward exchange market and explain **TWO (2)** types of forward exchange trades.

(7 marks)

(b) Recently, Malaysia's current account surplus has increased tremendously.

(i) Draw diagrams of Malaysia's loanable funds market and spot market for Malaysian ringgit (RM) against U.S. dollar. (8 marks)

(ii) Suppose such high current account surplus attracts people to reallocate their savings into Malaysia. Using the same diagrams drawn in part (i), illustrate and explain the likely impacts of such reallocation of saving on Malaysia's interest rates, quantity of loanable funds, quantity of the Malaysian ringgit (RM) and the exchange value of Malaysian ringgit (RM). (4 marks)

(c) Explain the following terms:

i) Interest-rate risk (3 marks)

ii) Default risk (3 marks)

[Total marks: 25 marks]

Question 3

(a) Explain the following approaches:

(i) Absorption approach (3 marks)

(ii) Monetary approach (3 marks)

(b) Suppose that real consumption expenditures in a nation are \$50,000, real investment expenditures are \$6,000, real government expenditures are \$8,000, real expenditures on imports are \$1,000, and real expenditure exports are \$500.

i) What are the nation's levels of real income and absorption? (4 marks)

ii) What is its trade balance? Is it a trade deficit or trade surplus? (3 marks)

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(c) (i) Write out the equation of wealth identity. (2 marks)

(ii) Using this wealth identity, explain the impact of a central banks open-market purchase of bonds on the exchange value of domestic currency. (6 marks)

(iii) Draw a diagram of the spot exchange market for domestic currency using the supply-and-demand framework. Explain and illustrate the effect of a central bank open-market purchase of bonds on the exchange value of the domestic currency under flexible exchange rate arrangement. (4 marks)

[Total marks: 25 marks]

Question 4

(a) Explain the following terms:

(i) Mercantilism (3 marks)

(ii) Capital mobility (3 marks)

(iii) Crowding-out effect (3 marks)

(b) If the central bank of a small open economy with relatively high capital mobility maintains a fixed exchange rate, explain the effects of an expansionary monetary policy action on its balance of payment and its real income level using IS-LM-BP graph. If the economy engaged in unsterilized monetary policies, what will happen to the money stock, LM schedule and the ultimate IS-LM equilibrium? (8 marks)

(c) The central bank of a small open economy with perfect capital mobility follows a floating exchange rate system. If the economy conducts an expansionary monetary policy, explain the effect of this policy on LM schedule, balance-of-payment, value of currency, IS schedule, income and interest rate using IS-LM-BP graph. (8 marks)

[Total marks: 25 marks]
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